



Role of the state in Economic Development

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This report is a summary of an online discussion held by IPR on 10 July 2021. The speakers were:

- *Mr. Asad Umar, Minister for Planning, Development, and Special Initiatives*
- *Dr. Ha-Joon Chang, Professor University of Cambridge*

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Humayun Akhtar Khan

- For over a quarter of a century, Pakistan has been borrowing excessively from abroad to meet various needs. We borrow to pay for imports, to service debts and even to meet Rupee expenditure. Only one-third of what we borrow goes into development expenditure
- Every government over the past 25-30 years has significantly increased Pakistan's debt. External debt has continued to grow exponentially. In the last 20 years, it has grown over three times
- The share of productive sectors in GDP, agriculture and manufacturing, is on the decline
- In growing developing economies, the share of agriculture in GDP declines, but the manufacturing sector grows. In Pakistan, the manufacturing sector is also sluggish. The economic growth has basically come from the services sector, which for the most part, is not exportable.
- The export/GDP ratio, which was at 17% in the 1990s, is now at 9%.
- Over the past 20 years, our economy has been dangerously close to default, with the current account mostly in deficit.
- We believe exports must grow and Pakistan's young population must get jobs and the state must play its role to help achieve these objectives
- Labour productivity is very low in Pakistan hence we need for the state to invest more in the people of Pakistan
- Even during the days when Pakistan had a significant amount of capital inflows, it did not take measures to support its manufacturing sector

Federal Minister Asad Umar

- Speaking in personal capacity, though some views may coincide with the government's, others may differ.
- What works for one country does not necessarily work for another. While it is good to learn from the experiences of others, but each country must do so with care, analyze and adapt practices to its own situation.
- Through experience and observing the situation not only in Pakistan but around the world, this mantra that is highly popular in Pakistan that “the state has no business being in business” is a very catchy slogan but is not necessarily true
- SOEs can play an important role in Pakistan, though a 21st century economy should be led by the private sector and by entrepreneurship. The state must take measures to provide conducive conditions for the private sector to make it internationally competitive.
- There are many examples of successful SOEs around the world. The key sector of energy is a prime example. Aramco, Pertamina, and others are successful state owned energy companies.
- The growth of Saudi Arabia and Qatar as exporters of oil and gas were brought about by SOEs.
- In terms of number of Fortune 500 companies, China overtook the US a few years ago. Eighty of these Chinese companies were state-owned.
- More than a decade ago, Pakistan's PSO competed head-on with the best companies in the world. This happened by appointing a capable and experienced Board.
- Yet there are other examples of state owned enterprises that did not see the same transformation. It suggests that direct intervention by the state is not always productive. One must be selective.
- The Pakistani private sector including the large corporations have not grown by developing innovative solutions or creative problem-solving methods or the ability to take risks. Nor is the private sector willing to put a significant amount of money at risk.

- In the private sector, the largest investment in recent years went to independent power production. That did not happen due to risk-taking or any other entrepreneurial skills. Their success comes from the level of access the company enjoyed on Constitution Avenue.
- Hence, the private sector invested a huge amount of money in IPPs. However, these investments were like corporate bonds with pre-determined yields hence there was no risk involved.
- There are some identified sectors, such as mineral development, with great potential to grow, but which require significant capital outlay, with both technical and business risks. Despite potential profits, there is minimal investments in mining.
- Hence, it comes as no surprise that the 1960s was the decade when Pakistan was the most advanced industrially. That was due to state intervention through cleverly devised mechanisms. DFIs and Pakistan Industrial Development Corporation (PIDC) played very roles.
- The PIDC stepped in for a short period of time, created institutions and then turned them over to the private sector. It was never a long-term engagement and that plan worked very well for Pakistan.
- Another example is that of the oil and gas sector in Pakistan, which has remained open for the private sector for the past three decades. Yet, for several decades, the three big players and profitable entities in Pakistan's oil and gas are state owned OGDCL, PPL and Mari Gas.
- Strategic intervention should be time-bound and should also be diverse. It must not focus on only one aspect alone. Statements like "the government has no business being in business" oversimplify matters.

Dr Ha-Joon Chang

- Let me start off with the example of a local South Korean car manufacturer Hyundai, set up as a joint manufacturing venture with Ford. It began manufacturing cars with almost all imported parts.
- Set up in 1967, it was basically at first a glorified mechanic shop as it produced only 3,000 cars in one year, which basically makes it 10 cars per day.
- In 1975, under the government's pressure, Hyundai came up with its own model called Pony—a small hatchback car, which not many people would want to buy. In 1975, Hyundai produced 10,000 cars while General Motors produced 4.8 million cars and Ford produced 1.9 million cars. GM produced about 200 times more than Hyundai.
- That year, nobody would have believed that in 40 years South Korea would produce more cars than Ford or General Motors and that Hyundai would become a bigger company than Ford.
- In 2009, Hyundai overtook Ford in car production. Hyundai is the number three car manufacturer in the world.
- In the 1960s, South Korea and Pakistan had almost the same level of per capita income. Six decades later, South Korea's per capita income is 25 times that of Pakistan.
- During these few decades, a major diversion in approach to development occurred between the two countries. As a result, South Korea, whose 80% of exports comprised primary commodities such as fish in 1960s, is now exporting cars, mobile phones, semi-conductors.
- Pakistan is stuck at the basic level of economic development. Fifty percent of its exports comprise textiles and rice, essentially primary products.
- Pakistan has failed to upgrade its productive abilities because it did not use policies that enabled South Korea, Japan, Taiwan, China and other countries to propel themselves forward
- These policies provided targeted trade protection, subsidized loans to strategic industries, heavily regulated foreign investments and more.

- On their own, foreign companies will not train employees and transfer technology. FDI receiving countries must push them to do so, as did Japan, Korea and China.
- The US, for example, pretends that it does not have any state-owned enterprise sectors and acts as the biggest champion of free trade. In fact, it has the largest state-owned enterprise and the most significant industrial policy in the world, which is the US military
- The Pentagon was behind most technological inventions that we see in everyday use. They include touchscreen, creation of the internet, building computer hardware and software and much more.
- Without the US military, there would be no corporate giants like IBM or Apple.
- All the semi-conductors were made by the US Navy and all aircraft technologies were derived from inventions by the US Air Force
- Similarly, the world's perception of Singapore is that it promotes free trade and is open to foreign investment, which is a fact. Yet, 22% of Singapore's GDP is derived from state-owned enterprises (SOEs). These SOEs include the famous Singapore Airlines. Eighty-nine percent of the land in Singapore is owned by the state
- The lessons from looking at these examples is that developing countries need to use technology to produce goods and for that, countries should have an educated, skilled workforce and well-trained managers, researchers and scientists. But they also need collective productive capabilities such as public research institutes, economic institutions and physical infrastructure.
- Another way to explain collective capabilities is by studying the example of, let's say a Pakistani engineer who goes to work in Germany. Their productivity increases by 25 times in Germany. This is because they are working in a system that encourages greater quality of collective capabilities
- Pakistan needs more effort at all levels, individual, by corporations, and by institutions. And Pakistan needs better infrastructure and services.
- Pakistan must research and understand how other countries developed and progressed over the years. US, Korea, China, Japan and other states used old style economic policies

to become rich. We need policies that nurture and encourage new infant industries and provide them protection as well, though for a limited time.

- Governments should also, other than providing support to their workforce, improve work ethics and discipline of the workers. One of the reasons of the success of East Asian countries was that while they did provide huge support to their workers, they were willing to cut off their benefits if they did not produce at a rapid pace
- The main challenge is to design policies that are pragmatic and benefit a country's growth. Each country must find its own formula for success. And for that to happen, those at the helm of affairs should be ambitious in pursuing their long-term objectives
- People used to laugh at Hyundai back in the 1970s when it said it wanted to become one of the largest companies in the world. Yet, that never stopped the company from growing.
- Development takes place in stages. South Korea didn't go from exporting fish to selling mobile phones overnight. The country did many things, in stages, some of which is being done by Pakistan. At one of its stages, it tried its hand at textile. So, an economy may start with those things, but it must keep moving forward. Then it moves on to the next thing and then the next level of complexity. It may have happened really fast for South Korea, but it happened in stages and through very pragmatic policies
- Unfortunately, there are some countries that are too ambitious but not pragmatic at all. Other countries are too pragmatic but not ambitious at all. We need to find a balance to this